

**CITY OF ANN ARBOR
RETIREE HEALTH CARE BENEFITS
PLAN AND TRUST**

FINANCIAL STATEMENTS

Fiscal Years Ended June 30, 2008 and 2007



Issued by: Retirement System, 532 S. Maple Rd, Ann Arbor, Michigan 48103
(734) 794-6710

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

TABLE OF CONTENTS

June 30, 2008 and 2007

	<u>Page</u>
INDEPENDENT AUDITOR'S REPORT	i
MANAGEMENT'S DISCUSSION AND ANALYSIS	ii-iii
FINANCIAL STATEMENTS	
Statement of Plan Net Assets	1
Statement of Changes in Plan Net Assets	2
Notes to Financial Statements	3-5
REQUIRED SUPPLEMENTARY INFORMATION	
Schedule of Funding Progress	6
Schedule of Employer Contributions	7
Note to the Schedule of Funding Progress and Schedule of Employer Contributions	8

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INDEPENDENT AUDITOR'S REPORT

To the Members of the Audit Committee
City of Ann Arbor Retiree Health Care Benefits Plan and Trust
Ann Arbor, Michigan

We have audited the accompanying statement of plan net assets of the City of Ann Arbor Retiree Health Care Benefits Plan and Trust as of June 30, 2008 and 2007, and the related statement of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the City of Ann Arbor Retiree Health Care Benefits Plan and Trust and do not purport to, and do not present fairly the financial position of the City of Ann Arbor, Michigan, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the City of Ann Arbor Retiree Health Care Benefits Plan and Trust as of June 30, 2008 and 2007, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and historical benefit information, as identified in the table of contents, are not required parts of the financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

December 1, 2008

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2008 and 2007

The following is a discussion and analysis of the City of Ann Arbor Retiree Health Care Benefits Plan and Trust's financial performance and position, providing an overview of the activities for the year ended June 30, 2008. This analysis should be read in conjunction with the *Independent Auditors Report* and with the accompanying financial statements.

The City of Ann Arbor Voluntary Employees Beneficiary Association (VEBA; the "Plan") is a single-employer defined benefit post employment healthcare plan established and administered by the City of Ann Arbor through the Board of Trustees of the Retiree Health Care Benefits Plan and Trust to provide health and life benefits for retirees and their beneficiaries.

Using this Annual Report

This annual report consists of two parts: (1) management's discussion and analysis (this section) and (2) the financial statements. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	Fiscal Year Ended June 30,	
	<u>2008</u>	<u>2007</u>
Total assets	\$ 63,824,710	\$ 64,057,714
Total liabilities	<u>32,267</u>	<u>35,878</u>
Net assets held in trust for healthcare benefits	63,792,443	64,021,836
Net investment gain	<4,851,925>	8,380,872
Contributions - employer	4,622,604	-
Retiree health benefits paid	<u>-</u>	<u>-</u>
Contributions in excess of benefits paid	4,622,604	-0-
General and administrative expenses	<u>72</u>	<u>19,990</u>
Net change in plan net assets	<u>\$ <229,393></u>	<u>\$ 8,360,882</u>

Overall Fund Structure and Objectives

The City of Ann Arbor VEBA Trust exists to pay health care benefits to retired members. The Plan is currently accumulating assets to generate investment earnings and there are no benefits currently being paid. The excess of contributions over benefits paid will allow for additional funding to increase investment income to a level where the Plan will generate adequate earnings to pay future benefits. The public capital markets represent the primary source of investments.

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2008 and 2007

Asset Allocation

It is the responsibility of the VEBA Board to determine the allocation of assets among distinct capital markets in accordance with allowable legal limits. Based on an asset allocation review conducted in 2006, which analyzed the expected returns of various asset classes, the Plan's actuarial assumption rate, and the risks associated with alternative asset mix strategies, the Board has established the following asset allocation:

<u>Asset Class</u>	<u>Target</u>	<u>Range</u>
Domestic Equity	65%	55-65
Fixed Income	30%	30-40
Real Estate	5%	0-10

The study has shown that this asset mix offers the optimal mix for meeting longer term goals. The asset classes stated above shall be further diversified (where possible) as to style and manager type to reduce risk further, while providing the opportunity for enhanced return.

Economic Factors, Investment Returns, and Other Important Matters

In 2007/08 the headlines were filled with financial disaster in the banking and other industries. Investors sought the safety of Government-backed bonds at the expense of virtually every other asset class. The equity collapse was world wide with the markets falling around the globe. On days the U.S. equity market experienced significant losses, the Asian and European equity markets would decline on the next trading day by a similar magnitude. Fixed income markets offered both positive and negative returns. Government bonds rallied strongly as investors sought their safety. Corporate bonds traded lower with few buyers.

The stock market is the principal investment forum utilized by the City's Retiree Health Care Benefit Plan & Trust. It is important to note that the Retiree Health Care Benefit Plan & Trust's purpose is to pay healthcare benefits to its members and it is through long-term investing that these promised benefits will be primarily funded. However, it is recognized that in the short term there will be market fluctuations that may result in negative returns for any given period. Such is the case for 2007/2008 which shows a -7.19% return for the year. Through its investment policy asset allocation, the Board has positioned the portfolio for the long-term investment objective to pay healthcare benefits to its members. In addition, to further maximize investment returns, management carefully monitors the performance of each of its investment managers and takes the necessary corrective action to ensure acceptable investment results.

The Plan is normally funded by contributions from the City of Ann Arbor. VEBA members are not required to contribute to the Plan. Current retiree medical and life benefits are budgeted and paid for out of various City of Ann Arbor departments.

Contacting the Plan Management

This financial report is intended to provide our citizens, taxpayers, and investors with a general overview of the Plan's finances and to show accountability for the money received. If you have questions about this report or need additional information, we welcome you to contact the City of Ann Arbor Retiree Health Care Benefits Plan and Trust Office at 532 S. Maple Rd., Ann Arbor, Michigan 48103, or (734) 794-6710.

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

STATEMENT OF PLAN NET ASSETS

June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Investments, at fair value	\$ 61,617,644	\$ 63,893,982
Accrued interest and dividends	217,158	162,203
Due from other funds of the City of Ann Arbor	<u>1,989,908</u>	<u>1,529</u>
Total assets	63,824,710	64,057,714
LIABILITIES		
Accounts payable	<u>32,267</u>	<u>35,878</u>
NET ASSETS		
Held in trust for retiree health care benefits	<u>\$ 63,792,443</u>	<u>\$ 64,021,836</u>

See accompanying notes to financial statements.

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

STATEMENT OF CHANGES IN PLAN NET ASSETS

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ADDITIONS TO NET ASSETS		
Investment income (loss)		
Interest and dividends	\$ 2,295,104	\$ 1,811,334
Net appreciation (depreciation) in fair value of investments	<u>(6,864,751)</u>	<u>6,777,408</u>
Total investment income (loss)	(4,569,647)	8,588,742
Less: investment expense	<u>(282,278)</u>	<u>(207,870)</u>
Net investment income (loss)	(4,851,925)	8,380,872
Contributions		
Employer	<u>4,622,604</u>	<u>-</u>
Total additions to net assets	(229,321)	8,380,872
DEDUCTIONS FROM NET ASSETS		
Administrative expenses	<u>72</u>	<u>19,990</u>
CHANGE IN PLAN NET ASSETS	(229,393)	8,360,882
Net assets - beginning of year	<u>64,021,836</u>	<u>55,660,954</u>
Net assets - end of year	<u><u>\$ 63,792,443</u></u>	<u><u>\$ 64,021,836</u></u>

See accompanying notes to financial statements.

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE A: PLAN DESCRIPTION AND CONTRIBUTION INFORMATION

The City of Ann Arbor Voluntary Employees Beneficiary Association (VEBA; the "Plan") is a single-employer defined benefit post-employment healthcare plan established and administered by City of Ann Arbor through the Board of Trustees of the Retiree Health Care Benefit Plan & Trust to provide health and life benefits to eligible retirees and their beneficiaries. Chapter 21 1:707 assigns the authority to amend the benefit provisions of the Plan to the City of Ann Arbor.

The Plan is normally funded by actuarially determined contributions from the City of Ann Arbor, under a trust agreement established pursuant to Section 501(c)(9) of the Internal Revenue Code, which allows for the formation of a VEBA. This fund is included as a pension trust fund in the City's financial statements.

VEBA members are not required to contribute to the Plan. Employer contributions for the year ended June 30, 2008 were \$4,622,604. Current retiree medical and life benefits are budgeted and paid for out of the various City of Ann Arbor departments.

Membership of the plan consisted of the following at June 30, 2007, the date of the latest actuarial valuation:

General	561
Police	151
Fire	<u>89</u>
Total Active Members	801
Retirees and Beneficiaries receiving benefits not currently funded by the plan	820
Terminated plan members not entitled to benefits	<u>117</u>
	<u>1738</u>
Number of participating employers	1

NOTE B: SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting: The VEBA statements are prepared using the accrual basis of accounting.

Method Used to Value Investments: Plan investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on national exchanges are valued at the last reported sales price. Investments that do not have an established market are reported at estimated fair values.

Administration: Administrative costs are financed through the Plan's investment earnings.

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE C: DEPOSITS AND INVESTMENTS

The Michigan Public Employees Retirement Systems' Investment Act, Public Act 314 of 1965, as amended, authorizes the Plan to invest in stocks, government and corporate securities, mortgages, real estate, and various other investment instruments, subject to certain limitations. The Plan's Board has the responsibility and authority to oversee the investment portfolio. Various professional investment managers are contracted to assist in managing the Plan's assets. All investment decisions are subject to Michigan law and the investment policy established by the Board.

The Plan's investments are held by independent investment management companies. Following is a summary of the Plan investments as of June 30, 2008:

	<u>Fair Value</u>	<u>Cost</u>
Investments at fair value, as determined by quoted market prices:		
Common stocks	\$ 37,099,913	\$ 37,059,776
Corporate bonds	20,997,390	21,005,515
Real Estate - Fund	2,893,078	3,251,104
Short-Term investments	<u>627,263</u>	<u>627,263</u>
Total investments	<u>\$ 61,617,644</u>	<u>\$ 61,943,658</u>

Interest Rate Risk

For investments, the risk that changes in interest rates will adversely affect the fair value of the investment is known as interest rate risk. The Plan's investment policy provides for securities with terms to maturity of up to 30 years. None of the investments held by the Plan as of June 30, 2008 are subject to interest rate risk.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Plan's investment policy provides that corporate bonds rated lower than BBB by Standard & Poor's should be limited to 10% of the investment portfolio. The corporate bonds are in an index fund, and are not rated. The Plan has no investments that are rated as to risk category at June 30, 2008.

Custodial Credit Risk

For investments, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Plan will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Plan's investment policy requires that investment securities be held in trust by a third-party institution in the Plan's name. As such, although uninsured and unregistered, the Plan's investments are not exposed to custodial credit risk since the securities are held by the counterparty's trust department in the Plan's name. Short-term investments in money market funds are not subject to custodial credit risk.

Concentration of Credit Risk

The Plan's Board has established ranges for investment asset allocation as follows:

<u>Asset Class</u>	<u>% Range</u>
Equities	55-65
Fixed Income	30-40
Real Estate	0-10

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED

Also, at the time of purchase, no more than 5% of the equity securities of a single issuer may be owned, and no security should be more than 5% of the total portfolio at market value.

Additionally, the State of Michigan Public Employee Retirement System Investment Act limits domestic equity participation to no more than 70% of the total fund market value and international investments to 20% of total fund market value. The investments are listed above and no individual investment exceeds these concentration parameters.

REQUIRED SUPPLEMENTARY INFORMATION

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

SCHEDULE OF FUNDING PROGRESS

(Amounts expressed in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	Unfunded Percentage of Covered Payroll [(b-a)/c]
6/30/2007	\$ 60,090	\$ 215,949	\$ 155,859	27.8%	\$ 50,678	307.5%
6/30/2006	55,250	197,199	141,949	28.0%	49,627	286.0%
6/30/2005	45,256	166,824	121,568	27.1%	47,225	257.4%
6/30/2004	39,163	131,703	92,540	29.7%	47,109	196.4%
6/30/2003	29,789	126,918	97,129	23.5%	46,213	210.2%

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

SCHEDULE OF EMPLOYER CONTRIBUTIONS

<u>Year Ended June 30,</u>	<u>Annual Required Contribution</u>	<u>Current Premiums Paid by City</u>	<u>Pre-funding Contributions to VEBA Trust</u>	<u>Percentage Contributed</u>
2008	\$12,360,028	\$ 7,737,424	\$ 4,622,604	100.00 %
2007	10,370,568	7,616,064	-	73.4 %
2006	8,099,607	7,292,343	7,065,913	177.2 %
2005	8,607,188	6,522,226	4,099,025	123.4 %
2004	7,871,938	6,083,674	7,803,872	176.4 %

City of Ann Arbor
Retiree Health Care Benefits Plan and Trust

NOTE TO THE SCHEDULE OF FUNDING PROGRESS
AND SCHEDULE OF EMPLOYER CONTRIBUTIONS

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the health care cost trend. Actuarial determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress, presented as required supplementary information following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The accompanying Schedule of Employer Contributions presents trend information about the amounts contributed to the plan by the employer in comparison to the ARC, an amount that is actuarially determined in accordance with the parameters of GASB Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortized any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

The City of Ann Arbor has met the ARC in accordance with GASB 45 through a combination funding approach, which is shown in the accompanying Schedule of Employer Contributions. Current retiree benefits are budgeted and paid for out of the various City departments. The City then made an additional employer contribution to the Retiree Health Care Benefits Plan and Trust for the purpose of pre-funding future benefits as actuarially determined.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation follows:

Actuarial Valuation:

Frequency	Annual
Latest valuation date	6/30/07
Actuarial cost method	Entry Age
Amortization method	Level percent of payroll - open
Remaining amortization period	30 years
Asset valuation method	5-year smoothed - market value

Actuarial assumptions:

Investment rate of return *	7.0%
Health care cost trend rate	12% initial 3.5% ultimate
Projected salary increases	3.5%
*Includes inflation at:	3.5%

Principals

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF THE FINANCIAL STATEMENTS**

To the Members of the Audit Committee
City of Ann Arbor Retiree Health Care Benefits Plan and Trust
Ann Arbor, Michigan

We have audited the financial statements of the City of Ann Arbor Retiree Health Care Benefits Plan and Trust as of and for the year ended June 30, 2008 and have issued our report thereon dated December 1, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Ann Arbor Retiree Health Care Benefits Plan and Trust's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Ann Arbor Retiree Health Care Benefits Plan and Trust's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Ann Arbor Retiree Health Care Benefits Plan and Trust's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal controls. We consider the following deficiency to be a significant deficiency in internal control over financial reporting:

TIMELINESS OF ACCOUNTING PROCESSES

At the beginning of our audit fieldwork, we noted that the monthly investment, employee/employer contribution information, and benefit payout accounting had not been performed for several months leading up to June 30, 2008. Therefore, management and the Board of Directors had not been provided with complete and timely financial reporting for decision-making purposes. This is particularly important considering current market conditions.

The financial reporting process should be designed to effectively accumulate, process, summarize, and present fairly a complete set of financial statements and supporting information on a timely basis. The timely completion of accounting record keeping and reconciliation of balance sheet accounts with the general ledger is a significant part of the internal controls of the City of Ann Arbor Retiree Health Care Benefits Plan and Trust. By not performing such reconciliations on a timely basis, the System has not maintained sufficient internal controls.

TIMELINESS OF ACCOUNTING PROCESSES - CONTINUED

We recommend that accounting record keeping and reconciliation of balance sheet accounts be completed on a monthly basis and that completed reconciliations be periodically reviewed by management and tied to the computerized general ledger. We also recommend that the System review and reconcile all accounts monthly and ensure that the balances are agreed with the computerized general ledger prior to audit fieldwork. The review procedures should be documented with the reviewer's initials and date of review and be retained for audit purposes.

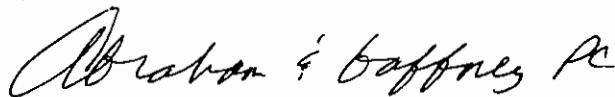
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We believe that the significant deficiency described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Ann Arbor Retiree Health Care Benefits Plan and Trust's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters.

This report is intended solely for the information and use of the Audit Committee and management of the City of Ann Arbor Retiree Health Care Benefits Plan and Trust and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Abraham & Gaffney PC". The signature is written in a cursive, flowing style.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

December 1, 2008